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IN THE

Supreme Court of the United States

October Term, 1979
No. 79-509

EXXON CORPORATION,

Appellant,

vs.

WISCONSIN DEPARTMENT OF REVENUE,

Appellee.

On Appeal From the Supreme Court of Wisconsin.

Motion for Leave to File Brief Amicus Curiae in Support of Appellee and Brief of Frank M. Keesling as Amicus Curiae in Support of Appellee.

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SUBJECT INDEX

Page

Motion for Leave to File Brief Amicus Curiae in Support of Appellee 1

Brief of Amicus Curiae on the Merits in Support of Appellee 7

Interest of Amicus Curiae 7

Argument 8

I.

The Separate Accounting Method Should Not Be Employed to Apportion the Income of a Unitary Business 8

A. Computation of Income of Separate Business 8

B. Deficiencies of Separate Accounting in Apportioning the Income of a Unitary Business 8

C. Cases Cited Do Not Support Appellant 18

D. Specific Source of Income Not Established 19

E. Superior Oil Co. v. Franchise Tax Board Is Directly Contrary to Appellant 20

F. Hans Rees' Is Contrary to Appellant's Position 22

II.

Appellant's Predecessor Was Engaged in the Conduct of a Unitary Business 24

III.

Conclusion 25

Page

Exhibit "A". Letter of Consent Dated January 29, 1980 1

Exhibit "B". Title 18, Bank and Corporation Tax 2

TABLE OF AUTHORITIES CITED

Cases Page

Butler Bros. v. McColgan, 17 Cal.2d 664 (1941), Aff'd 315 U.S. 501 (1942) ..2, 8, 10, 11, 12, 13, 19

Caterpillar Tractor Co. v. Lenckos, 77 Ill.App.3d 90, 395 N.E.2d 1167 (1979) 9

Coca Cola Company v. Department of Revenue, 271 Or. 517, 533 P.2d 788 (1975) 2

Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472, 183 P.2d 16 (1947) 2, 5, 8

General Motors Corporation v. The State of Colorado, 181 Colo. 360, 509 P.2d 1260 (1973) 4

Hans Rees' Sons v. North Carolina, 283 U.S. 123 (1931) 22

John Deere Plow Co. of Moline v. Franchise Tax Board, 38 Cal.2d 214, 238 P.2d 569 (1951) ..8, 9

Kennecott Copper Corporation v. State Tax Commission of Utah, 27 U.2d 119, 493 P.2d 632, dismissed 409 U.S. 973 (1972) 4

Montana Department of Revenue v. American Smelting and Refining Company, ... Mont. ...., 567 P.2d 901 (1977) dismissed 434 U.S. 1042 (1978) 3

Multistate Tax Commission v. International Harvester, Inc., No. 1-76-182 (D. Idaho, Nov. 13, 1979) 4

Southern Pacific v. McColgan, 68 Cal.App.2d 48, 156 P.2d 81 (1945) 3

Standard Oil Company v. Wisconsin Tax Commission, 197 Wis. 630, 223 N.W. 85 (1929) 18

Page

Studebaker Corp. v. Gilchrist, 244 N.Y. 114, 155 N.E. 68 (1926) 15

Superior Oil Co. v. Franchise Tax Board, 60 Cal. 2d 406, 34 Cal.Rptr. 545, (1963) 20, 21, 22

Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920) 9, 10, 13, 19

Wheeling Steel Corporation v. Fox, 298 U.S. 193 (1936) 3

Textbooks

Altman and Keesling, Allocation of Income in State Taxation (1946) (2d Ed. 1950) p. 100 .....4, 12, 23, 24

Boren, 18 U.C.L.A. Law Rev., p. 478 (February, 1971) 14

Keesling, A Current Look at the Combined Report and Uniformity in Allocation Practices, 42 The Journal of Taxation, pp. 106, 109, 110 (Feb., 1975) 3, 5, 14

Keesling and Warren, California's Uniform Division of Income For Tax Purposes Act, 15 U.C.L.A. Law Rev., pp. 156, 167 (1967) 19

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Motion for Leave to File Brief Amicus Curiae in Support of Appellee.

The undersigned, Frank M. Keesling, hereby respectfully moves for leave to file the attached Brief Amicus Curiae in this case. The consent of the Attorney General for the State of Wisconsin has been obtained. See Exhibit "A" attached hereto. In the belief that the Exxon Corporation is denying consent for the filing of any Amicus Curiae briefs, no effort has been made to obtain the consent of such corporation for the filing of the attached brief.

The undersigned has been interested in the problem of the allocation and apportionment of income for state tax purposes for nearly 50 years. As counsel to the California Franchise Tax Commissioner (the predecessor of the California Franchise Tax Board) during the years 1935-1939, the undersigned made

many contributions to the state's allocation and apportionment policies including the following:

1. Adopted a rule requiring the use of the three factor formula of property, payroll and sales in the apportionment of the income of a unitary business.

2. Made the administrative decision that the taxpayer in *Butler Bros. v. McColgan,* 17 Cal.2d 664 (1941), Aff'd 315 U.S. 501 (1942) was engaged in the conduct of a unitary business and that its California income should accordingly be determined by the formula method rather than by separate accounting.

3. Prepared the State's trial brief in the *Butler Brothers* case which served as the basic brief throughout the entire course of litigation and which set forth the reasons relied upon by the California Supreme Court in upholding the use of the formula method and which led this Court to affirm the California decision.

4. Instituted the combined return or combined report policy under which the income of a unitary business is apportioned by the formula method regardless of whether the business is conducted by one corporation with a number of branches or by a number of commonly owned corporations. This policy was upheld by the California Supreme Court in *Edison California Stores, Inc. v. McColgan,* 30 Cal.2d 472, 183 P.2d 16 (1947). It has since been adopted by some nine other states. It was upheld by the Supreme Court of Oregon in *Coca Cola Company v. Department of Revenue,* 271 Or. 517, 533 P.2d 788 (1975). The combined return policy has also been upheld by the Montana

Supreme Court in *Montana Department of Revenue v. American Smelting and Refining Company,* ..... Mont. ....., 567 P.2d 901 (1977). (Appeal to the Supreme Court dismissed for lack of jurisdiction, 434 U.S. 1042 (1978)). For a detailed discussion of the policy see Keesling, *A Current Look at the Combined Report and Uniformity in Allocation Practices,* 42 The Journal of Taxation 106 (February, 1975). (This article was based upon a talk given to the Multistate Tax Commission at its annual meeting in Denver, Colorado, 1974).

5. Extended to the state corporate income tax field the commercial domicile doctrine first announced by this Court in *Wheeling Steel Corporation v. Fox,* 298 U.S. 193 (1936). This extension was upheld in *Southern Pacific v. McColgan,* 68 Cal.App.2d 48, 156 P.2d 81 (1945). Since then, virtually all of the states which impose taxes on or measured by corporate income have adopted a similar policy.

In 1939, the undersigned entered private practice in Los Angeles, California, first as an associate and then as a partner of the firm of Loeb and Loeb. He is now, and has been for several years past, the Senior Attorney for that firm. Since entering private practice, he has engaged in the following activities with respect to problems similar to those involved in the instant case:

1. Represented a large number of corporations in connection with the allocation and apportionment of income for state tax purposes; such representation has included some of the larger and best known conglomerates in the country.

2. Appeared recently as an expert witness in the following state tax cases:

(a) *General Motors Corporation v. The State of Colorado,* 181 Colo. 360, 509 P.2d 1260 (1973). (Witness for the State); (b) *Kennecott Copper Corporation v. State Tax Commission of Utah,* 27 U.2d 119, 493 P.2d 632, Appeal dismissed 409 U.S. 973 (1972). (Witness for the Taxpayer); (c) The instant case when it was before the Wisconsin Tax Commission (Witness for the State); (d) *Multistate Tax Commission v. International Harvester, Inc.,* No. 1-76-182 (D. Idaho, Nov. 13, 1979), regarding whether the United States Steel Corporation should be held in contempt of the orders and rulings of that Court. (Witness for the Commission).

3. As co-author, contributed a number of chapters to a treatise discussing the allocation and apportionment of income. See Altman and Keesling *Allocation of Income in State Taxation* (1946) (2d Ed. 1950). One of the chapters so contributed was Chapter 5 in both editions entitled "Principles of Allocation of Business Income". This chapter discusses in some detail the identical problem involved in this case, *i.e.,* whether separate accounting or the formula method should be employed in determining the income attributable to a state from a business conducted both within and without the state. Based upon the reasons set forth therein, the conclusion was expressed that the formula method should be employed in the case of a unitary business. This chapter also articulates for the first time what has come to be known as the dependency or contribution definition of

a unitary business (both editions, p. 101). Subsequently, this definition was employed by the California Supreme Court in the *Edison Stores* case, 30 Cal.2d 472, 478. From there, this definition has spread all over the country and has been cited extensively in texts, law review articles, briefs and in opinions of appellate courts including the Supreme Courts of numerous states.

4. Author or co-author of various law review articles dealing with the allocation and apportionment of income, some of which are cited in the state court's opinion in the instant case and others in the appellant's brief. The subject of separate accounting versus formula is also discussed to some extent in the article relating to the combined return referred to above. 42 The Journal of Taxation 109, 110 (February 1975).

FRANK M. KEESLING,
Amicus Curiae.

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BRIEF OF AMICUS CURIAE ON THE MERITS IN SUPPORT OF APPELLEE.

Interest of Amicus Curiae.

Amicus Curiae is not representing anyone in this matter. As stated in the Motion for Leave to file this brief, he was a witness for the State of Wisconsin in the instant case when it was before the Wisconsin Tax Commission. Based upon his experience and presumed knowledge of the matter, he testified that the business conducted by the appellant's predecessor was unitary and that the formula method was properly applied to determine the income derived from marketing activities in Wisconsin. He is still of the same opinion for the reasons, among others, set forth herein.

This brief does not constitute a comprehensive discussion of the law relating to the apportionment of income for state tax purposes. Rather, it consists of a number of comments on various points which may be of some assistance to the Court in resolving the issues presented.

ARGUMENT.

I.

The Separate Accounting Method Should Not Be Employed to Apportion the Income of a Unitary Business.

A. Computation of Income of Separate Business.

As the California Supreme Court held in *Butler Bros. v. McColgan*, 17 Cal. 2d 664, 678 (1941), Aff'd 315 U.S. 501 (1942), if a business conducted within a state is separate and distinct from the business conducted outside the state, the separate accounting method may appropriately be used to determine the income from the business conducted within the state. In such a case, the income is computed in much the same manner as it would be computed in the case of a single business operated by a taxpayer entirely in one state. The first step is to compute the gross receipts of the business. The second step is to compute the cost of goods sold. By subtracting the latter amount from the gross receipts, the gross income of the business may then be determined. The net income of the business can be determined by subtracting the selling expenses and various overhead expenses from gross income.

B. Deficiencies of Separate Accounting in Apportioning the Income of a Unitary Business.

Where, however, the business conducted in the state is an integral portion of a business carried on both within and without the state, the separate accounting method should not be employed to compute the income attributable to the portion of the business within the state. *Edison California Stores, Inc., v. McColgan*, 30 Cal.2d 472, 478, 183 P.2d 16, 20 (1947); *John Deere Plow Co. of Moline v. Franchise Tax Board*, 38 Cal.

2d 214, 238 P.2d 569 (1951). To employ separate accounting to apportion the income of a unitary business is just as wrong as it would be to use a formula method to apportion the income of two or more separate businesses. *Caterpillar Tractor Co. v. Lenckos*, 77 Ill. App.3d 90, 395 N.E. 2d 1167 (1979), currently on appeal to the Illinois Supreme Court. It is like putting a square peg in a round hole or a round peg in a square hole.

There are several specific reasons why the separate accounting method should not be applied to apportion the income of a unitary business.

1. Impossible To Determine Income Specifically. First of all, the use of the separate accounting method in the case of a unitary business constitutes an attempt by mathematical computations to divide the indivisible. This point was clearly recognized by this Court in *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920). The company was engaged in the manufacture of typewriters and accessory products in Connecticut and the sale thereof, partly in Connecticut but mostly in other states. It computed its income attributable to Connecticut by separate accounting. Based upon this method it concluded that all of its income was attributable to sales and none to the manufacturing operations in Connecticut. This Court, in an opinion by Mr. Justice Brandeis, made the following statement with respect to the separate or specific computation of the income of a unitary business:

> "The profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sale in other States. In this it was typical of a large part of the manufacturing business conducted in

the State. The legislature in attempting to put upon this business its fair share of the burden of taxation was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders." 254 U.S. 113, 120-121.

2. Receipts Not Specifically Allocable. It is impossible to make the computations required by the separate accounting method. The first step is to compute the gross receipts attributable to the business in the state. If such business is truly separate and distinct, this computation can be made fairly easily and accurately. Where, however, the operations in the state constitute an integral portion of a unitary business conducted in part outside the state as well, there are no separate receipts attributable to any state. Instead, the receipts, although collected in a particular state, are the common product of a series of transactions, many of which take place in other states.

3. Expenses Not Specifically Allocable. Similarly, it is impossible to compute the expenses attributable to the earning of income in the taxing state. From the fact that certain expenses are incurred there, it does not follow that they were all attributable to the earning of income there. Instead, they contribute to the earning of income in all the states where the business is conducted. This point regarding expenses is well illustrated by *Butler Bros. v. McColgan*, 17 Cal.2d 664, 678 (1941), Aff'd 315 U.S. 501 (1942). The company operated seven wholesale department stores in as many states, one of which was in California. Its head office was located in Chicago, Illinois. Most of the goods for these stores were purchased centrally.

The company computed its California income by a separate accounting computation similar to that offered by the appellant in the instant case. Although the business as a whole realized a substantial profit, the company contended, based upon its separate accounting computations, that it sustained losses in California.

By buying in large quantities, it was able to obtain a purchasing profit *i.e.*, it obtained its goods for all of its stores at a price less than what otherwise would have been possible. It was able to buy in large quantities only because it sold in large quantities. Therefore, there was a direct unitary relationship between purchases and sales. California contributed some of the sales. Thus, the operation of the California store made contributions to the earning of the income of the business as a whole by helping to obtain lower prices for the goods sold in all the stores. The expenses incurred in California benefitted the entire business and should have been so charged as the Court in effect held by upholding the formula method which apportions the entire income considered as a single unit.

The relationship between sales and the ability of a corporation to realize profits through the reduction of costs is even more apparent in the case of a company engaged in the production, manufacturing and marketing of goods, as in the case of appellant, than in the case of *Butler Brothers* which engaged in manufacturing operations only to a small extent. If a company produces or manufactures only a small quantity, the per unit cost may be prohibitive. If, however, a large volume is manufactured, the per unit cost may be reduced substantially, thereby contributing to

the earning of larger profits. But, as in *Butler Brothers,* a company may manufacture in large quantities only if it sells in large quantities.[1]

Large-scale selling may also make numerous other contributions to the functioning of a company's business as a whole. Thus, it may permit centralized purchasing of machinery, equipment and supplies, thereby realizing substantial savings. It may also permit large-scale research which may be of inestimable value to the successful operation and growth of the company. In the case of a company like Exxon's predecessor it may permit large-scale exploratory activities and the development of better methods of drilling, extracting and refining oil. Selling on a large scale may also, as noted in the opinion of the California Supreme Court in *Butler Brothers,* 17 Cal.2d 664, 669, permit the taxpayer to obtain the services of more experienced and abler managerial and other personnel than might otherwise be possible.

Thus for the same reasons as in *Butler Brothers,* a substantial portion of a company's overall income should be apportioned to the states where marketing activities take place. The separate accounting method, however, ignores the contributions made by sales and is thus highly deficient in this respect.

4. Use of Fictitious Sales. There is a fourth significant reason for rejecting the separate accounting method as applied to a unitary business. In keeping with the notion that the manufacturing division is separate from the selling division, the goods transferred from the manufacturing division to the selling division are con-

[1]For further discussion of this point see Altman and Keesling, *Allocation of Income in State Taxation* (1946), (2d Ed. 1950), p. 100 (both editions).

sidered "sold". The "price" at which the goods are so "sold" is considered to constitute the separate gross receipts of the manufacturing division. By subtracting the actual cost of goods sold and also various overhead expenses, figures purportedly constituting the separate "gross income" and separate "net income" of the manufacturing division are computed. In turn, the "price" at which the goods are "sold" to the selling division constitutes the cost of goods to that division for computing what purports to be the separate "gross income" and "net income" of that division.

The procedure described above is wholly fictitious. There are no sales and no income is realized upon the transfer of goods between divisions of the same taxpayer.

5. Manipulation of Terms of Inter-Divisional "Sales". Furthermore, the terms of putative sales between divisions, unlike actual sales at arms length to strangers, are under the control of the taxpayer and may be manipulated to suit its tax convenience.

If it is desired to attribute all or most of the income to the states where sales take place, this can be contrived by "selling" the goods to the sales division at cost, or at a very low markup. This was done in the *Underwood Typewriter* case with the result that $1,293,643.95 of the company's income was attributed to states other than Connecticut and only $42,942.18 was attributed to Connecticut where the manufacturing operations and the executive office of the company were located.

In the *Butler Brothers* case the goods centrally purchased or manufactured were likewise charged to the wholesale stores at cost. Although the company still reported a loss in California, the overall effect of this method was to attribute all of the company's

income to the stores where sales were made and none to Illinois, where the headquarters office of the company was located and where the purchases were made.

For a number of years after California adopted the Bank and Corporation Franchise Tax Act in 1929 the members of a well-known and profitable California industry avoided the franchise tax by a similar technique. They sold all of their products to out-of-state distributing subsidiaries at cost. As a result, the producing companies reported no California income. Instead, all of the income was realized by the distributing companies and, for the most part, escaped taxation. In 1936 Counsel to the California Franchise Tax Commissioner instituted the combined report policy to prevent this type of tax avoidance.[2]

The above technique is also commonly used to avoid Federal income taxes as well as the income taxes of states which do not employ the combined report policy. For example, Company A manufactures foreign language encyclopedias which are in great demand in various foreign countries. The business is highly profitable. It organizes Company B, a wholly-owned subsidiary, in the Bahamas (or in some other jurisdiction which either does not tax income or taxes it at very low rates). It organizes another wholly-owned subsidiary, C, which functions as a sales organization in various foreign countries. The goods manufactured by A are sold to B at cost or at a very small markup. B resells the goods to C at a very high markup.

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[2]See Keesling, *A Current Look at the Combined Report and Uniformity in Allocation Practices*, 42 Journal of Taxation 106 (February, 1975).

For an excellent, extensive discussion of California's allocation and apportionment policies see Boren, 18 U.C.L.A. Law Rev. 478 (February 1971).

As a result, most of the income escapes tax both here and abroad.

If, on the other hand, it is desired to attribute most or all of the income to the state where the manufacturing operations are located, this can be accomplished by "selling" the goods to the sales division at a high markup. This markup may be based on the markup commonly prevailing in the industry in the case of wholesale sales. Or perhaps the taxpayer itself makes some arms-length wholesale sales and uses the same markup for its inter-division "sales". This technique was used successfully in *Studebaker Corp. v. Gilchrist,* 244 N.Y. 114, 155 N.E. 68 (1926). The Studebaker Corporation was engaged in the manufacture of motor vehicles in Michigan. The business was highly profitable. It organized a number of subsidiary sales corporations to which it sold its motor vehicles at a price which would not permit the subsidiaries to realize a profit. One of the subsidiaries was located in New York. The New York Tax Commission in an effort to attribute to New York a fair share of the profits derived from the manufacture of motor vehicles in Michigan and the sale thereof in New York, attempted to require the filing of a consolidated return. The New York Court of Appeals, in an opinion by Justice Cardozo, held that a consolidated return could not be required since it was not specifically authorized by the New York tax law.

The same technique of arranging a sale of products by the manufacturing division to the sales division at a high markup is also used extensively and successfully to avoid federal income taxes as well as state income taxes in states which do not use the combined report policy. For example, a company which is engaged

in the sale of men's clothing organizes a manufacturing subsidiary in some foreign jurisdiction which does not impose an income tax. The manufactured goods are sold to the United States selling subsidiaries at a price sufficiently high to prevent them from realizing a profit. As a result the income escapes tax completely except in states like California and nine other states which require the filing of a combined report and thereby apportion some of the income to such states by the application of an apportionment formula.

6. Conjecture as to Amount of Profits if Business Had Been Conducted Differently. There is a sixth compelling reason why the separate accounting method should not be used to apportion the income of a unitary business. Use of this method to determine the income of different divisions is fundamentally based upon conjecture as to the amount of income each division would have realized if the business of the company had been conducted in a different manner.

Thus, in the instant case, the conclusion that the production division realized a certain amount of income is based upon the assumption that such an amount of income would have been realized if the company instead of refining all the oil it produced had instead sold all such oil at arm's length to other refineries.

Again, the conclusion as to the amount of income that the refining company realized is based upon an assumption as to the amount of income such division would have realized if, instead of using its own produced oil for refining purposes, it had instead purchased oil on the open market and on the further assumption that instead of marketing most of its refined products it had sold all of such products to independent marketing companies.

These assumptions are not only hypothetical and conjectural but also highly questionable. There are substantial reasons for believing that if the three divisions had been operated as separately-owned companies, the aggregate profits may have been far, far less than the amounts realized under the common management and control of appellant's predecessor. Certainly, the movement in this country has been toward larger and larger business establishments and greater and greater integration of operations. There are a great many conglomerates composed of several hundred corporations engaged in a wide variety of business activities which are welded together into what is essentially one business under common management and control. For the most part, they function very effectively and result in greater profits than would be realized if each of the various companies were to be operated separately.

Some of these advantages resulting from large scale operations under common ownership, management and control have previously been mentioned. There are many others, but there is no need to belabor the point.

In any event, the states are confronted with enough problems in apportioning the income of businesses as they are actually conducted, without also considering how the income should be apportioned if the businesses had been conducted differently!

7. Impossibility of Monitoring Terms of Inter-divisional Transfers. Even if there were some merit to the separate accounting method, it should be noted that as a practical matter the states simply do not have the personnel, either in numbers or experience, to police or monitor the terms of the vast number of inter-divisional transfers made by hundreds of thou-

sands of corporations in numerous states and countries and which involve a myraid of different kinds of products. Under the formula method inter-divisional transfers are not considered as sales and accordingly it is unnecessary to check the terms of such transfers. In this respect as well as others, the formula method is much simpler than the separate accounting method to administer.

C. Cases Cited Do Not Support Appellant.

Appellant cites a number of cases which upheld the use of separate accounting in the apportionment of the income of integrated oil companies (App. Br. 40-44). These cases belong to a bygone era. They were out of step at the time with the decisions of this Court and with those of most other states. The Supreme Court of Wisconsin as presently constituted is clearly no longer in accord with the views expressed in *Standard Oil Company v. Wisconsin Tax Commission*, 197 Wis. 630, 223 N.W. 85 (1929). It is highly questionable whether any of the other cases cited have any vitality today.

These cases were decided prior to the great swing, in the early 60's toward achieving uniformity among the states by the use of the formula method instead of separate accounting. Prior thereto, there was so much chaos and confusion in the allocation policies of the different states that numerous bills were introduced in Congress to require all the states to use the same method of apportionment.

It is significant to note that these bills did not require that the states use separate accounting. In view of the different methods of applying separate accounting, such a requirement would have resulted in no

uniformity at all. Instead, the bills provided that the states must use a formula method consisting of the two factors of property and payroll. Furthermore, these bills contemplated that the formula would apply to all of a corporation's income, non-business as well as business.

Although the proposed legislation requiring uniformity was defeated, the states, in an effort to prevent possible future legislation of a similar character, began putting their houses somewhat in order. Many of the states adopted the Uniform Division of Income For Tax Purposes Act drafted and sponsored by the National Conference of Commissioners on Uniform State Laws in 1957. For a discussion of this development see Keesling and Warren, *California's Uniform Division of Income For Tax Purposes Act*, 15 U.C.L.A. Law Rev. 156 (1967). It is of considerable significance to note that the uniform act provides that "all business income shall be apportioned to the state by the use of a formula consisting of the three factors of property, payroll and sales". *Id.* 167.

D. Specific Source of Income Not Established.

Appellant claims that unlike the taxpayers in *Butler Brothers* and *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978) it has supplied proof as to the source of its income (App. Br. 15, 25). It has done no such thing. All it has done is supply separate accounting computations based upon the use of various assumptions which may or may not be true. The same type of proof was furnished and found inadequate in both *Underwood* and *Butler Bros.*

Appellant seeks to distinguish the instant case from other cases in which separate accounting computations

of income have been rejected by calling its computations "separate functional accounting" *Id.* But whether separate accounting is called "separate functional accounting", "geographical separate accounting" (App. Br. 25) or plain "separate accounting" it is still separate accounting subject to all the deficiencies of that method when applied to a unitary business.

E. Superior Oil Co. v. Franchise Tax Board Is Directly Contrary to Appellant.

The case of *Superior Oil Co. v. Franchise Tax Board*, 60 Cal.2d 406, 34 Cal.Rptr. 545, (1963) deserves special consideration here. *Superior* was engaged in exploring for oil and the extraction of oil in numerous states including California. Its headquarters office was located in Los Angeles. Unlike appellant's predecessor, (and other major integrated oil companies), it was a non-integrated company. Thus, it did not refine the oil it produced nor did it sell refined products either at wholesale or retail. Instead, it sold all of its oil at the well-head at posted field prices. Furthermore, Superior successfully used separate accounting in most states other than California. In most of these states, this method indicated the company had sustained losses in such states. Nevertheless, in computing its California income it employed a formula consisting of the three factors of property, payroll and sales which attributed a substantial amount of income to its operations outside of California rather than losses as shown by its own tax returns based upon its own separate accounting computations.

The California Franchise Tax Board was of the opinion that the operations in California were sufficiently separate and distinct from those outside of the state as to permit a reasonably accurate determination of

the California income by the separate accounting method. This opinion was reinforced by the fact that there was but little operational interdependency between the wells in California and those in other states. It was also reinforced by the fact that the taxpayer's own computations indicated that it sustained losses outside of California.

The Franchise Tax Board accordingly prepared its own separate accounting computation in accordance with established methods of accounting in the oil industry. This computation indicated that the operations in other states sustained a loss of $7,000,000, a figure consistent with the taxpayer's computations and that the operations in California produced a profit of some $10,000,000. An additional assessment was made on this basis. Thus the state urged the use of separate accounting and the taxpayer urged the use of formula method, a reversal of the usual roles in cases involving formula versus separate accounting.

The California Supreme Court unanimously sustained the taxpayer. It held that notwithstanding the various elements of separateness, the taxpayer was engaged in one unitary business and that the formula method was properly employed.[3]

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[3]Amicus Curiae served as Special Counsel to the California Attorney General in connection with the Superior Oil Co. litigation. He shared the belief of the California Franchise Tax Board that Superior's operations in California were sufficiently separate from its operations in other states as to permit the use of separate accounting. He has since come to appreciate more fully the enormous importance of Management and the centralized performance of numerous functions such as financing, advertising, research, etc., in the successful operation of a business.

Since the decision in *Superior*, the California Franchise Tax Board has broadened its classification of businesses as unitary. The text of the Board's current regulation relating to this matter is attached hereto as Exhibit B.

The separate accounting computations in the *Superior* case, unlike those of Appellant's predecessor, did not involve fictitious sales between divisions and again unlike the computations of Appellant's predecessor did not speculate as to the amount of profit *Superior* would have earned if it had conducted its business differently from the way in which it was actually conducted. Instead they were based upon actual sales and actual receipts.

Unlike Superior, appellant's predecessor was engaged in the operation of a large integrated oil company which was far more unitary in character than the business operated by Superior. It follows accordingly that if the California Supreme Court was correct in upholding the formula method in *Superior,* then surely the Wisconsin Supreme Court correctly held that appellant's predecessor was engaged in the conduct of a unitary business and that the formula method was properly employed.

F. Hans Rees' Is Contrary to Appellant's Position.

Appellant relies heavily on *Hans Rees' Sons v. North Carolina*, 283 U.S. 123 (1931) in support of its position that separate accounting may be used in the instant case. *Hans Rees'* does not support its position but instead is directly contrary thereto.

In that case, North Carolina used a single factor formula of property to apportion the company's income from a business carried on within and without the state. That formula attributed more than 80 percent of the taxpayer's income to North Carolina. This Court did not hold that the manufacturing operations constituted a business separate and distinct from the selling operations. It did not hold that the separate accounting

method could properly be employed to compute the income earned in North Carolina. All that this Court held was that the particular formula employed attributed an amount of income to North Carolina out of all proportion to the business done there and failed to take into account the extensive sales operations in other states.

Exactly the same statement can and should be made with respect to the separate accounting method in the instant case, *i.e.*, it attributes to the states where the production and refining operations were carried on an amount of income out of all proportion to the business done there and does not take into account the extensive sales and marketing activities in other states including those in Wisconsin.

If North Carolina had employed a formula which gave weight to the selling activities, there is little doubt that this Court would have upheld it.[4]

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[4]See Altman and Keesling *Allocation of Income in State Taxation* (1946) (2d Ed. 1950), p. 100 (both editions), where the following statement regarding the Hans Rees' case is made:

> The case of Hans Rees' Sons, Inc. v. North Carolina is often cited for the proposition that the separate accounting method is preferable to the formula method even in the case of a unitary business. An examination of the opinion in the case, however, clearly shows that it does not support that proposition. The company involved was engaged in the manufacture and sale of leather goods. It maintained a factory in North Carolina but carried on extensive sales and purchasing activities outside the state. Income attributable to North Carolina was determined by assigning to that state that portion of the total income which the value of tangible property within the state bore to the total value of such property within and without the state. The formula resulted in allocating approximately 89 per cent of the corporation's entire income to North Carolina. The court refused to approve the result not on the grounds that a formula could not be used, but on the grounds that in the particular case, the particular formu-

(This footnote is continued on next page)

II.

Appellant's Predecessor Was Engaged in the Conduct of a Unitary Business.

There can be little doubt that the business operated by appellant's predecessor was unitary in character. That business consisted of a large integrated organization devoted to the making of profits. Such profits were realized as a result of a series of transactions including the exploration for oil, the drilling of wells, the extraction of oil, the transportation of the oil to refineries, and the marketing of the refined products in various states including Wisconsin. These transactions were connected together in much the same manner as the links in a chain. Without exploration and drilling and the extraction of oil, there would have been no oil to process. Without the refinery operations there would have been no refined products to market. Without the marketing operations, there would have been no profits. Whether or not greater profits might have been realized if the business had been conducted differently is irrelevant. The classification of a business as separate or unitary must be made on the basis of the manner in which it was actually conducted, not on a "might have been" basis.

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ia employed consisting simply of the property factor did not give proper weight to the extensive activities without the state and that, accordingly, the result reached was unreasonable. If other factors had been used, such as payroll and sales, which would have given weight to the extensive out-of-the-state activities, the formula would unquestionably have been upheld.

III.

Conclusion.

It is respectfully submitted that the marketing operations in Wisconsin constituted an integral part of a unitary business carried on by appellant's predecessor within and without Wisconsin and that the Wisconsin Supreme Court properly upheld the use of the formula method in computing the income earned in Wisconsin.

Respectfully submitted,

FRANK M. KEESLING,
LOEB AND LOEB,
Amicus Curiae.

EXHIBIT "A".

The State of Wisconsin
Department of Justice
Madison
53702

(Letterhead)

January 29, 1980

Frank M. Keesling, Esq.
One Wilshire Building
Los Angeles, California 90017

Re: *Exxon Corporation v. Wisconsin Department of Revenue,* No. 79-509

Dear Mr. Keesling:

I hereby give my consent on behalf of my client, the Wisconsin Department of Revenue, to your filing of a brief *amicus curiae* in the above matter.

I am very appreciative of your assistance.

Sincerely yours,
/s/ Gerald S. Wilcox
Gerald S. Wilcox
Assistant Attorney General

GSW:ls

EXHIBIT "B".

Title 18, Bank and Corporation Tax.

Reg. 25120. Definitions of Business and Nonbusiness Income.

(a) Business and Nonbusiness Income Defined. Section 25120(a) defines "business income" as income arising from transactions and activities in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. In essence, the business income of the taxpayer is that portion of the taxpayer's entire net income which arises from the conduct of the taxpayer's trade or business operations. For purposes of administration of Sections 25120 to 25139, inclusive, the income of the taxpayer is business income unless clearly classifiable as nonbusiness income under Sections 25120 to 25139, inclusive and the regulations thereunder.

Nonbusiness income means all income other than business income.

(b) Two or More Businesses. One corporate entity may have more than one "trade or business." In such cases, it is necessary to determine the business income attributable to each separate trade or business. The income of each business is then apportioned by an apportionment formula which takes into consideration the instate and outstate factors which relate to the business the income of which is being apportioned.

Example: The taxpayer is a conglomerate with three operating divisions. One division is engaged in manufacturing aerospace items for the federal

government. Another division is engaged in growing tobacco products. The third division produces and distributes motion pictures for theaters and television. Each division operates independently; there is no strong central management. Each division operates in this state as well as in other states. In this case, it is fair to conclude that the taxpayer is engaged in three separate "trades or businesses." Accordingly, the amount of business income attributable to the taxpayer's trade or business activities in this state is determined by applying an appropriate apportionment formula to the business income of each business.

The determination of whether the activities of the taxpayer constitute a single trade or business or more than one trade or business will turn on the facts of each case. In general, the activities of the taxpayer will be considered a single business if there is evidence to indicate that the divisions under consideration are integrated with, dependent upon or contribute to each other and the operations of the taxpayer as a whole. The following factors are considered to be good indicia of a single trade or business; and the presence of any of these factors creates a strong presumption that the activities of the taxpayer constitute a single trade or business:

(1) Same type of business: A taxpayer is generally engaged in a single trade or business when all of its activities are in the same general line. For example, a taxpayer which operates a chain of retail grocery stores will almost always be engaged in a single trade or business.

(2) Steps in a vertical process: A taxpayer is almost always engaged in a single trade or

business when its various divisions are engaged in different steps in a large, vertically structured enterprise. For example, a taxpayer which explores for and mines copper ores; concentrates, smelts and refines the copper ores; and fabricates the refined copper into consumer products is engaged in a single trade or business, regardless of the fact that the various steps in the process are operated substantially independently of each other with only general supervision from the taxpayer's executive offices.

(3) Strong centralized management: A taxpayer which might otherwise be considered as engaged in more than one trade or business is properly considered as engaged in one trade or business when there is a strong central management, coupled with the existence of centralized departments for such functions as financing, advertising, research, and purchasing. Thus, some conglomerates may properly be considered as engaged in only one trade or business when the central executive officers are involved in the day-to-day operations of the various divisions and there are centralized offices which perform for the divisions the normal matters which a truly independent business would perform for itself, such as accounting, personnel, insurance, legal, purchasing, advertising and financing

(c) Business and Nonbusiness Income; Application of Definitions. The classification of income by the labels customarily given them, such as interest, dividends, rents, royalties, capital gains, is of no aid in determining whether that income is business or nonbusiness income. The gain or loss recognized on the

sale of property, for example, may be business income or nonbusiness income depending upon the relation to the taxpayer's trade or business.

The following are rules and examples for determining whether the particular type of income is business or nonbusiness income:

(1) Rents and royalties form real and tangible personal property: Rental income from real and tangible property constitutes business income when the rental of such property is a principal business activity of the taxpayer or the rental of the property is related to or incidental to the taxpayer's principal business activity.

Example (A): The taxpayer operates a multi-state car rental business. The income from car rentals is business income since such activity is the taxpayer's principal business.